

# Legal Management Services, Inc.

Helping attorneys create financial independence

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## **Financial Independence for Lawyers**

**All you need to know about Budgets, Receivables, Collections,  
Profitability, Spending, and More.**

*By: Jerry Schwartz, President of Legal Management Services, Inc.*

A goal of each individual lawyer should be to become financially independent. What does financial independence mean and how do you achieve it? Webster's New Collegiate Dictionary defines finance as money or other liquid resources and independence as freedom from the necessity for working for a living. To achieve financial independence the individual must have an idea of the amount of money or other liquid resources that would be needed in order to not have to work for a living. This is your nest egg. The first step is to develop a statement of net worth. This can be accomplished in the following ways:

A. Prepare a list of assets and liabilities; subtract the liabilities from the assets to arrive at your net worth.

B. Another is to regularly use an accounting and check writing program i.e. Quicken or Microsoft Money. Print a net worth statement as a report.

C. Logon to <http://www.bygpub.com/finance/NetWorthCalc.htm>, the BYG Publishing website for a form to calculate your net worth.

The second step is to prepare a personal budget with reasonable income expectations and achievable goals. To become financially independent you must control your expenses, liabilities and/or outlays for capital items i.e. homes, autos, etc. The sum of expenses, liability payments and capital outlays is your Number.

There are many theories from financial planners to determine what your nest egg should be in order to provide you with your annual Number. Some theories are so conservative and seem so hard to achieve that individuals give up before they can get a good start. The theory that seems most reasonable to me is that your annual expenses should not exceed five percent of your nest egg. If your Number is \$100K after social security and other pensions are considered, you should have \$2 million set aside as a nest egg ( $100,000/.05 = 2,000,000$ ).

How do you go about accumulating your nest egg? One way for lawyers is to maximize the profitability of the law firm by treating it as a business. The following issues should be reviewed in maximizing the profitability of the firm:

- A. Prepare an annual budget
- B. Utilize a timekeeping system
- C. Review management reports
- D. Review financial statements

- E. Examine work in process
- F. Monitor accounts receivable
- G. Utilize technology and training
- H. Market the practice

## **BUDGET**

There are three major components to a law office budget: Fee and Other Income; Expenses; and Net Income. Most law offices make light of the budgeting process, because they say it is difficult or impossible to budget for fee income. However, it is a figure in the budget which can be arrived at through process of elimination and then tested for reasonableness.

The budget process can start from the bottom up by having each owner submit a plan to reach a satisfactory level of personal compensation within the firm's compensation plan. This forces some personal planning on the part of the owners and helps to adjust the expectations of the firm's income generation capacity. The next step is to review the expenses of the office and make projections for the next year based on the information at hand. Once the amounts from the personal plans and the expenses are compiled, an amount of Fee and Other Income needed to provide for the two components can be determined. The reasonableness of the Fee and Other Income needed to support the personal plans and expenses can then be tested. Billing rates, billable hours, realization rates, other cash requirements and non-cash expenses can be analyzed to determine if the Fee and Other Income budget is reasonable. If the Fee and Other Income component is reasonable, all three components, the budget, are in place for proper financial planning and control for the next fiscal year.

Budgeting is like a good wine or aged cheese, it improves with age. Initial budgets are generally weak; however, they do improve each year. The time to begin the process is in late fall, so the plan is in place before the year begins. Control of law office finances can begin from day one of the new fiscal year. Effective planning and control are requisites of successful operations.

### **TIMEKEEPING**

A revenue generation program is made up of the following:

A. An adequate timekeeping system which allows the timekeeper to record billable and non billable time. This shows the timekeeper a list of accomplishments on a daily basis and allows the timekeeper to compare today's accomplishments to goals for billable and non billable time and shows the total contribution to the firm.

B. Rules to insure that time is recorded contemporaneously. More billable time is recorded and the short periods do not suffer.

C. Review of the time records for the following reasons:

1. Provides for a review of the type of work being performed.
2. Identifies poor work habits.
3. Helps to determine the effective use of personnel.
4. Eliminates the discounting of time by the timekeeper.
5. Billing is easier and more orderly when timekeeping is not left to memory.
6. Higher economic rewards are possible because more time is recorded under a structured timekeeping approach.

7. Profitability by type of case and timekeeper can be determined.
8. Better client services are performed.

It is the responsibility of the timekeeper to record time. Partners should show a good example to the non-partner timekeepers of the firm. It is the duty of the partner to contribute to the success of the firm and one method of contribution is to teach by example. The partners should ensure that other timekeepers are trained properly in the timekeeping system and in time entry preparation. It should be clear to all that proper timekeeping habits are criteria used in annual evaluations and have a financial impact on the entire firm.

Contrary to popular opinion, the administrative assistant is not responsible for recording time, but can help by keeping logs of the activities of timekeepers. The logs can track visitors, phone calls, mail and documents produced. The administrative assistant is responsible for recording the time in the billing system or submitting the time sheets to the proper person on a timely basis and to verify that time was recorded on the proper client account.

### **MANAGEMENT REPORTS**

Management reports should be prepared and reviewed on a regular basis. The review of the following reports by timekeeper and client and matter is essential to a profitable practice:

- Hours worked - current and year to date
- Hours billed - current and year to date
- Hours written off - current and year to date
- Premiums - current and year to date
- Discounts - current and year to date
- Work in progress - aged
- Accounts receivable - aged and write offs

Cost recovery systems should be reviewed to insure that all charges attributable to a client account are being properly charged. Whether the systems are manual or automated, the data should be reviewed on a monthly basis to insure proper handling.

### **FINANCIAL STATEMENTS**

The following reports should be reviewed monthly:

Income statement or Profit and Loss Statement

Balance Sheet

Report on trust account funds

On the income statement, the sole practitioner or law firm manager should look at costs to insure that proper controls are in place or to determine whether certain expenditures are even needed in the current practice. Many times invoices are paid without much thought as to whether the lawyer needs the expenditure to operate.

A word of caution is always important in the review of expenses. Cutting costs is the easiest way to increase the profits of the firm and it is the one method that everyone has some familiarity and experience. Many lawyers tend to cut too much or in the wrong places and productivity is drastically affected. Salaries, occupancy costs and insurance premiums make up a large portion of the total expense of a law practice and are expenses which are very difficult to control. Net profits of the law practice are not going to be affected by the amount of No.2 lead pencils or paper clips that are purchased. The costs need to be reviewed, but the time spent on revenue generation will be the big payoff for the firm's net profit.

Do you have an adequate time, billing and accounting system? Do you have cost recovery procedures in effect so client costs are charged to client files? Do you review the reports that are generated? Do you manage the practice? If you can answer yes to these questions, you are on the way to attaining an

acceptable net profit from your practice and on the road to financial independence. If the answer to any of the questions is no, then it is time to get back to basics.

The balance sheet cash accounts should be reviewed and compared against the bank statements and reconciliations. In addition, the trust account bank balance should be compared against a list of trust account balances; so that we can ensure that the funds in trust are correct. Any accounts receivable balances should be reviewed to see their age and to determine whether the debtor is complying with the payment schedule. Employment tax payables should be for current payrolls and any notes payable balances should be reviewed. The profit on the balance sheet should be compared against the profit on the income statement to ensure the balancing of the accounting system.

### **WORK IN PROCESS**

The work in process report is the inventory of unbilled work and costs by lawyer. It allows the reader of the report to see the total outstanding work in process for all timekeepers in the law office. Since the responsible lawyer has the relationship with the client, he or she should review this report on a monthly basis and make the decision whether or not to bill the client at this time. If the time cannot be billed, the responsible lawyer should look at the total of costs on each matter to see if the costs on the matter can be billed.

### **ACCOUNTS RECEIVABLE AND COLLECTIONS**

Accounts receivable reports should be reviewed monthly. If cash flow and profitability are not where they should be; then a collection program for delinquent accounts may be the missing link. The following schedule will provide a basis for adequate monitoring of accounts receivable balances.

A. Send reminder statements for all invoices more than thirty days old from the billing department without lawyer intervention.

B. A mild letter is sent by the office manager or billing clerk at forty-five days indicating that payment of the statement has not been received and that the owners are concerned and would like to know of any problems that may exist. The client should be encouraged to communicate with a specific individual other than the primary lawyer.

C. A low key and non-confrontational call should be made if the statement is not paid within sixty days. The purpose of the call should be to get information and a commitment for payment by a certain date. A follow up should be made with the client every two weeks until payment is made.

D. At ninety or one hundred twenty days and subject to the Code of Professional Obligation a decision should be made by the firm to cease representation, write off the account or send the matter to an outside collection lawyer.

An accounts receivable aged report is an invaluable tool for law offices to monitor the value of the receivables from clients. Historically the older the receivable the less value it will have to the firm. It is extremely important to have a collection policy in force to ensure an adequate cash flow for the firm. The accounts receivable should be monitored every other week to make sure that client balances are not getting too old.

If the client eventually pays the statement after considerable effort on the part of the firm, a decision must be made to accept further business from the client. Evaluate each slow paying client on an individual basis. It may be that the firm contributed to the slow pay by not providing information to the client or that the failure to pay on a timely basis was beyond the control of the individual client. If you have a collection policy which helps to ensure the cash flow of your office and is handled professionally, the slow pay client may be a more loyal client in the future.

## **TECHNOLOGY**

Utilization of technology is very important to the financial success of the law office. The benefits of updating technology should be considered by those who have not updated hardware or software in the recent past. Productivity of the law office and client service is affected when hardware and software systems do not operate correctly. Upgrades should be made in both hardware and software systems and the cost of the upgrade should be spread over the expected usefulness of the technology.

## **TRAINING**

Once the new systems are installed, insist on adequate training for all staff including the lawyers. Take the time to work with the vendor to establish a training schedule that can be implemented in your office and spend the money in both cash and time to accomplish the task. Initially, the firm should have an overview and basic training and then the firm should contract for advanced training and support. This gives the firm the best return for its investment.

## **MARKETING**

Many lawyers will argue that the law office has the best lawyers in town and that it always turns out a quality and timely work product and therefore there is no need for a marketing and business development program. These qualities are expected by the client and do not set the law office apart from other law offices in the area.

Marketing can be defined as the performance of an activity which directs the flow of services from the provider of services to the client in order to satisfy the client's needs and accomplish the objectives of the law office.

Satisfaction of client needs is the primary focus of a good marketing and business development program. The lawyer must keep informed of the nature of the client's business in order to serve. For many years lawyers solved the problems of

their clients when they were called upon. A good marketing and business development program will identify possible problems that a client may encounter and provide preventative solutions to these problems. Is a lawyer that is uninformed about the business of the client really serving the best interests of the client? How will a lawyer know the business of the client unless the lawyer is proactive in keeping informed? A good contact management system is essential for marketing the law practice.

Many law offices have identified ways in which they can be informed about the business of their clients. Since clients give testimonials, lawyers that do not have marketing and business development programs will not have to worry about clients being "stolen"; the clients will be "running away" to other lawyers in order to get the services that they feel they deserve.

Besides keeping informed about the nature of a client's business, a marketing and business development program will maintain the professionalism of the law office in the following ways:

- A. CLE requirements for each lawyer in the office will be strictly enforced to maintain a quality practice.
- B. Calendars and dockets are in place to ensure timeliness.
- C. Clients are informed of the status of the matter being handled with copies of correspondence and regular billing.